Disruption Diaries

SME banking and lending

Small businesses, big growth.

INSIDE: Results of Mambu's global survey of 1,000 SMEs focussed on access to funding and drivers of growth.

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Richard Lim
CEO of Retail Economics

SME businesses are the lifeblood of interconnected international economies. Whether it be a 'mom and pop corner shop' servicing a local community, or a hungry tech start-up in a WeWork office, SME businesses disproportionately contribute to job creation, economic activity, and breathe lifeforce into many communities.

The pandemic ushered in enormous changes in how we work, play and shop, with its repercussions still reverberate across society. It's been astonishing to witness the resilience and adaptability of SME businesses around the world. Against the backdrop of heightened uncertainty, structural upheaval and a seismic shift towards digital, SME businesses have risen to the challenge. Necessity really has been the 'mother of invention' as companies pivoted their business models towards a new set of consumer expectations.

International markets have also undergone significant change in the last decade. Access to digital platforms has been democratised, whether they've been used to promote products, distribute them worldwide, or to share stories through social media. This has undoubtedly broken barriers to entry. Whether it's ordering tartan fabric from Scotland or spices from Indonesia, SME businesses have witnessed opportunities arise in ways that were unimaginable just a few years ago.

However, access to capital is a particular area where democratisation of digital has matured at a slower pace. All too often, businesses looking to scale quickly and seize opportunities are choked by exhausting application processes. Stifled by slow and inefficient practices, access to fund raising is no longer fit-for-purpose in today's fast paced, digital world. The industry is playing catch-up. But it's lacklustre transition is potentially coming at an enormous cost to the economic recovery.

Access to capital is a matter of 'do or die' for many businesses that are battling the competition, or even leading disruption. Investing in digital propositions is essential for firms striving to boost digital capacity as we transition through an era of pandemic-induced impacts.
As a newly formed digital ecosystem emerges from the pandemic, SME businesses risk being left behind.

They're often at the whim of an 'analogue' funding process – unfit for the digital era. This pool of untapped potential may hold the key for sustainable economic growth if nurtured in the right way.

Despite these obstacles, I remain optimistic. Businesses that successfully navigated the choppy waters of COVID-19 are now in a stronger position following unparalleled levels of government support. If there's one thing I've learnt over the last couple of years, it's to believe in the incredible SME businesses that have shown courage and ingenuity; but importantly, these businesses are now positioned to thrive – provided they have timely and responsible access to capital in order to scale."

About Richard Lim

Richard is Chief Executive Officer of Retail Economics, an independent economics research consultancy focused on the consumer and retail industry. He also sits on the Strategic Advisory Board at the University of East Anglia's School of Economics, ranked in the top 10 departments in Economics in the UK.

Introduction

SMEs are big business.

They make up around 90% of businesses worldwide and employ more than half of the global workforce. According to the World Bank, formal small and medium enterprises (SMEs) also contribute up to 40% of global domestic product (GDP) in emerging economies.

They may have a smaller headcount, but SMEs have always been the backbone of the global economy and significant contributors to job creation. In fact, according to ILO, SMEs represent over 90% of businesses in many countries and more than 65% of employment worldwide.

However, the road to SME success is not easy. From securing funds for launch and scaling business efforts to weathering global crises like coronavirus and supply chain chaos,
founders have their work cut out. Access to tools and services to make SMEs' lives easier beyond traditional funding routes is essential.

So, how is the SME ecosystem evolving, and what does this mean for lending and financial services towards small
businesses? We surveyed over 1,000 SMEs globally to find out.

The pandemic effect

The pandemic had a dual impact on SMEs.

Small and medium businesses were hit hard by COVID-19; in August 2020, McKinsey reported that 70% of European SMEs saw their revenues decline as a result.

But it also supercharged SME growth.

Research from our Disruption Diaries report on emerging consumer financial tribes identified Covidpreneurs as a key consumer group globally. It showed almost a quarter of consumers surveyed worldwide had set up their own business since the pandemic, with a further 54% more likely to set up their own business or side hustle than before COVID-19.

In this report, we've spoken to 1,000 SME owners around the world, who launched their business in the last five years, and our research shows 15% started trading after being put on furlough or made redundant due to COVID-19.

However, the pandemic isn't just responsible for creating more SMEs. It's changing their expectations of lenders and what they're looking for in their financial services. If this demand goes unaddressed, it represents a huge missed opportunity for the global economy and SME lenders.

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In this report we surveyed

1,000

SME owners

Our research shows

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Barriers to growth

The status quo risks holding entrepreneurs back, depriving the market of innovative new products and services, if SMEs can't access the funding they need and don't have friends, family, or their own savings to make up the difference.

The fact that SMEs identify barriers, such as arduous application processes and overly complex paperwork and admin, demonstrates that the SME lending space is ripe for disruption. If lenders can resolve some of these issues, they can support the next generation of entrepreneurs and create lucrative new business opportunities.

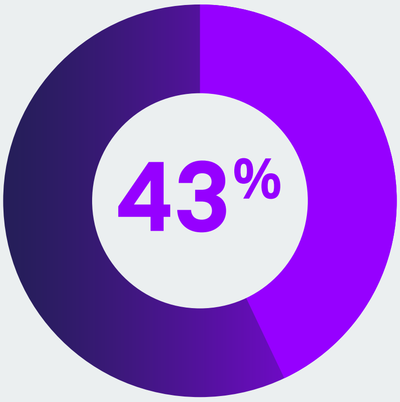
Lenders that will successfully attract SMEs understand their evolving needs and appreciate that a seamless and tailored lending services are necessary to capitalise on this lucrative market.

And digitisation is crucial. With SMEs increasingly looking for lenders with better digital options, alternative lenders are in the ascendancy, and traditional players must innovate to keep up.

Global findings

Sources and types of funding

Personal networks are important at every level of business but our research shows they're a lifeline for SMEs.



Almost half (43%) of the SME owners we surveyed globally said they used funds from friends and family to help set up their business, rising to 57% among SME owners from Indonesia.

In fact, friends and family were the top funding source in all countries surveyed except Germany and Sweden where business partners and digital-only banks were the top sources, respectively.

The pandemic has increased reliance on these personal networks. A total of 47% of businesses launched since March 2020, and 48% of those launching soon, have been at least partially funded by friends and family.

Other key sources of income for SMEs include traditional banks, building societies/credit unions (30%), personal funds (28%) and business partners (27%).

Outside of friends, family and personal funds, short-term loans are the most popular source of external funding with over a quarter (26%) of SMEs launched in the last five years taking out this type of loan. This is closely followed by start-up loans (25%), business lines of credit (22%) and business term loans (22%).

Our research also found that businesses primarily funded by unsecured loans are more likely to take out short-term loans (32%) than those primarily funded by secured loans (25%).

47%

of businesses launched since March 2020

48%

of those launching soon, have been at least partially funded by friends and family

Barriers to funding

Part of this increasing reliance on friends and family for funding could be attributed to the barriers SMEs face when attempting to secure capital.

The biggest barriers SMEs face include not having enough starting capital, with 30% of businesses identifying this factor as one of the top three barriers. This is followed by too much paperwork and admin in the lending process (28%) and cash flow not being considered strong enough (27%). Slow lending speeds (26%), arduous application processes (25%) and rigid lending criteria (25%) were also identified as big barriers.

These obstacles mean the road to funding isn't smooth for many SMEs.

And it appears to have become more difficult since the pandemic, correlating with the rise in reliance on friends and family. Whilst 28% of businesses launched before March 2020 say they found it difficult to access sufficient funding, this percentage rises to 32% among businesses launched since March 2020 and 33% among those launching in the near future.

Additionally, businesses primarily funded by unsecured loans are more likely to have experienced problems securing sufficient funding (39%) than those that are primarily funded by secured loans (27%).

30%

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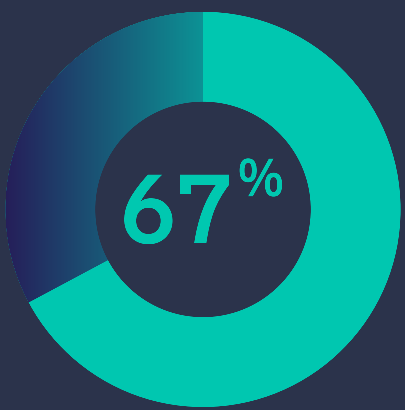
The cost of insufficient funding

Difficulty securing funding is a widespread issue for SMEs around the world.



Over the last five years, two-thirds of SMEs (67%) say they have been unable to secure the amount they need - or any funding at all - on at least one or more occasions.
And whilst the largest SMEs, by headcount, find it the easiest to access funding, they are also the most likely to have been unable to secure the amount of funding they need.

Again, the impact of the pandemic is keenly felt. The proportion of businesses struggling to access sufficient funds is higher among SMEs launched after March 2020, with 71% unable to secure the funding they need or any funding, on at least one or more occasions.

This failure to find funding costs SMEs and makes it harder to evolve their offering and remain competitive. Of those SMEs that have been unable to gain sufficient funding, our research found that 35% have experienced cash flow issues; 33% have been unable to launch new products or services and 30% have been unable to hire effectively, upgrade or improve business technology or pay back creditors. With cash flow issues being one of the barriers to securing funding, SMEs can find themselves in a vicious circle of decline.

35%
have experienced cash flow issues

33%
have been unable to launch new products or services

33%
have been unable to hire effectively

Choosing a lender and benefits

Lenders looking to tap into the SME market should consider the unique needs and preferences of SME owners if they want to attract their custom.

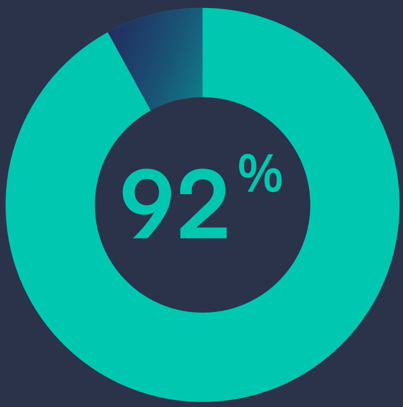
Our research found that **the length it takes to apply for a loan is one of the most important considerations for SMEs when choosing a lender.**

A short application process was cited among the top three most important considerations when trying to secure funding by more than three quarters (76%) of global SMEs, tied with long-term repayment terms (76%) and narrowly behind low-interest rates (81%).

The digital capabilities of lenders have also become increasingly important to SMEs. Appetite for digital services has shot up since the pandemic; two thirds (66%) of both SMEs launched since March 2020 and those launching in the near future say better digital services are an important consideration, compared to just 53% launched before March 2020.

Switching lenders and the application process

But lenders shouldn't assume they're locking in SMEs for the long term once they've been chosen.



The vast majority of SMEs (92%) are open to switching lenders if a competing lender offered something different or improved their offering.

Of these businesses, almost half would switch lenders to gain better borrowing benefits and incentives (49%) or better financial options (47%), while more than one third would switch for better digital services (35%).

The attraction of digital services - such as a mobile app to view and manage lending options - grows as the size of SMEs increases. The largest SMEs are most tempted to switch lenders to gain access to better digital services, with over half (52%) of businesses with 101 to 250 employees considering switching for this reason.

Improving the application process

Difficulty securing funding is a widespread issue for SMEs around the world.

As lenders look to attract SMEs, they must also carefully consider their application processes. Traditionally lengthy and time consuming, loan applications need bringing into the 21st century.

The vast majority of SMEs globally are interested in faster loan decision processing (79%), more flexible loan conditions (78%), tailored offers and services (76%) and low or no collateral requirements for loans (75%).

What’s next?

92%

of SMEs open to switching globally for better service

The message from our research is clear: SMEs want better support and they’re not afraid to change lenders to find it.

With 92% of SMEs open to switching globally, if a competitor offers a better service or something different, lenders can’t afford to be complacent. Here’s what the market needs to do:

1. Digitalise services

Our research shows that 35% of SMEs open to switching lenders would switch for better digital services, rising to over half (52%) of the biggest SMEs.

If lenders want to keep hold of their customers and attract new ones, investing in technology is a must. Features like mobile apps to view and manage lending options help make the lives of busy founders easier, and they’ll reward lenders who can offer them the speed and efficiency that digitalisation brings.

Lending has now entered the digital age. And lenders of all stripes - from traditional banks to emerging alternative players - need to offer products that reflect this.

2. Speed up the application process

Digitalisation can play a part in expediting the loan application process, the speed of which is a key differentiator for SMEs.

The time it takes to apply for a loan is one of the most important considerations for SMEs when choosing a lender, with three quarters of SMEs (76%) listing it as a key consideration. The vast majority of SMEs globally (79%) also want faster loan decision processing from lenders.

The way to win more SMEs is to streamline the application process and return loan decisions faster.

3. Tailor services to SMEs

SMEs shouldn't be an afterthought. Lenders who are serious about this market need to interrogate the loan terms they're offering smaller businesses.

Our research found the top consideration for SMEs when choosing a lender was low-interest rates (81%), with long-term repayment terms a critical draw for three out of four (76%) businesses.

Almost half of SMEs open to switching lenders would be pulled away by better borrowing benefits and incentives (49%) or better financial options (47%). Additionally, SMEs want flexibility and a level of personalisation in their loans, with 78% interested in more flexible loan conditions and 76% interested in tailored offers and services.

Consequently, lenders that want to be leaders in the SME field must ensure they're offering and advertising the most competitive terms possible.

4. Cater for loan differences

Lenders also need to be mindful of the various terms and consequences of different types of loan, and build their products accordingly.

For example, SMEs funded primarily by unsecured loans are much more sensitive about financial options and more open to incentives. We found that SMEs primarily funded by unsecured loans are more likely to consider switching for better borrowing benefits and incentives than those primarily funded by secured loans (66% compared to 46%), and are more attracted to better financial options (72% compared to 43%).

Lenders looking to win more SME customers should consider improving their benefits and incentives and updating their financial options for applicants with unsecured loans.

5. Pay attention to regional differences

SMEs are largely attracted by the same features but lenders operating across international markets should be aware of the regional differences at play.

For instance, German SMEs place great importance on the level of customer support and say 24-hour customer service is the most important consideration when choosing a lender. While SMEs in Singapore are keen to see automatic credit review and collection as part of the loan application process.

This demonstrates the importance of regional customisation and why knowledge of the local market is vital if lenders want to truly capitalise on the SME opportunity.

Partner contributions

Jason Oakley
CEO, Recognise Bank

SMEs are already bouncing back from COVID-19, and many are taking it as an opportunity to grow and reimagine their businesses, such as using the surplus commercial space left by retailers and offices impacted by the pandemic to expand or create a bricks and mortar presence.

The challenge they face, as they have done for several years, is finding a funding partner that can help them turn those plans into reality. The main-stream banks often don't have the expertise, the people on the ground or the risk appetite to support these ambitious growth plans.

Business is built on relationships and that is also true of finance. SMEs looking for funding should find a lender they can talk with, discuss their plans, their forecasts and their financial circumstances. That can't be done via an algorithm, a call centre or the tick box approach to lending many big banks take these days.

It's the reason why Recognise Bank has invested in regional relationship managers who truly understand the SME sector. We use technology to speed up decisions and enhance the role our relationship managers play, not to replace them.

So, my advice is simple, find a bank that cares about your business as much as you do.

Arnoud van Zelderen
CEO, New10

The pandemic forced SMEs to reassess their business models to adapt quickly to the new situation, innovating their core business. As a result, the demand for digitization and alternative financing solutions has accelerated. The need for businesses to get fast clarity on their funding opportunities in its turn has stimulated banks to digitalise and provide fast and clear processes for loan applications.

With digitalisation becoming the standard, the relationships between customers and banks have shifted towards a more equal balance. For financial institutions this means that we're moving towards more of a partnership between customer and lender, broadening up the role as solely a money provider. The question is: "How can we as a financial institution support SMEs best in their business ambitions? "

Empower SMEs to access the funding they need

At New10 it's our mission to empower SMEs to access the funding they need. The era of lengthy and complicated loan applications is well and truly over, we empower entrepreneurs to take control of when and how they borrow money. Removing unnecessary friction in terms of time and effort with a fully digitalized customer journey enables SMEs to quickly switch gears and to take the next step with their business. That means offering fast clarity on lending possibilities, providing the tools that make finance management easy, and giving personal support when needed.

Carsten Smith
COO, kompasbank

kompasbank

The banking sector has witnessed a large wave of concentration and consolidation over the last decades and SMEs have too often been neglected with a lack of focus from established players. SMEs across Europe lack access to financing and high quality services from incumbent banks where long lead times to get a loan limits faster growth and job creation. The increasing control that banks de facto have over the SMEs' lending and financing opportunities demotivates business owners and restricts their level of ambition.

COVID-19 has highlighted that SMEs need lending solutions that are more flexible and tailored to each SMEs individual situation. Not tomorrow, but today!

We firmly believe that in order to help SMEs reach their full potential banks need to go above and beyond what they have traditionally offered. There is a need to serve SMEs with efficient banking solutions and provide sufficient financing options both in the direct interactions with the bank but also as embedded finance solutions directly in the systems they use to run their business on a daily basis. Lastly, banks need to go beyond banking by offering products and services that help SMEs run, control and grow their business smarter and more efficiently.

Andrei Shestak
Chief Marketing Officer, Salt Edge

SALTEDGE

SMEs versus COVID-19: who's winning?

SMEs are winning, no doubt. And here is why:

COVID-19 has changed the economic paradigm, no doubt. While the big companies have been transitioning from offline to online, SMEs were dealing with their share of challenges. Being a small firm involves having a smaller internal capacity to embrace digital tools and this would have slowed down the process.

The potential challenge has been effectively mitigated thanks to open banking. First of all, thanks to the affordable financial tools that address their needs including accounting and cash management. With these processes' automation under open banking, SMEs started turning to alternative sources of funds, helping them go beyond plain survival throughout COVID-19. Small businesses did not stay behind multi-billion dollar corporations but transitioned from cash-based transactions to digital financial transactions in a secure environment, among many other steps forward that have been taken.

Yes, there is still a lot of work to be done to support SMEs, especially from a regulatory standpoint. But great things take time. And small businesses need more than time to keep it going.

Natalia Moose
Director of Marketing, EMEA, nCino

ncino®

The pandemic drove radical shifts in how financial institutions conduct business and adjust to ever-changing client behaviour. Between digitisation and growing client demands, SMEs are less satisfied with the traditional lending experience. Instead, lenders need to provide SMEs quick, secure and personalised experiences. For institutions that lend to SMEs and their strategies center around the craft of relationship banking, the need for systems that help take administrative burdens off employees' plates, supports better communications, and generates faster decisions for customers is critical. Well-connected cloud-based systems that enhance how SME lenders can listen, support and provide finance will continue to be a major force in helping to further transform the financial services industry as we emerge from COVID-19.

We anticipate digitisation and adoption of cloud-based systems to continue at a record pace. Lenders can get value from the technology they implement - including data interpretation, a better understanding of what's going on, and automating things like the frontend and credit assessment to deliver a better SME lending experience and build strong relationships.

Ernesto del Villar Hernandez
Chief Technology and Innovation Officer, IRIS

SMEs are not limited to their relationships with banks. Today, other financial institutions and nonfinancial institutions can be reached directly via the web. Credit analysis is now based on alternative and open data. Loans should be as flexible as possible, changing with market and company-specific conditions.

IRIS is a digital banking platform that caters to SMEs. To increase our lending capacity to this vital segment, we knew we would have to scale efficiently, and the only way to do just that is on the cloud. We chose Mambu, and became Colombia's first purely digital e-bank to exclusively service the SMEs.

Customers can open online savings accounts from anywhere in the country. They can also transfer funds between IRIS and other bank accounts, make vendor and payroll payments, schedule automatic transactions and set up other acquiring and payment collection services. SMEs can also gather and analyze data in real time to gauge the financial health of their businesses. It's user experiences like these that best ensure customer loyalty.

Mambu is the cloud banking platform where modern financial experiences are built. Launched in 2011, Mambu fast-tracks the design and build of nearly any type of financial offering for banks of all sizes, lenders, fintechs, retailers, telcos and more. Our unique composable approach means that independent components, systems and connectors can be assembled in any configuration to meet business needs and end user demands. Mambu supports hundreds of customers in over 65 countries - including N26, BancoEstado, OakNorth, Raiffeisen Bank, ABN AMRO, Bank Islam and Orange Bank.

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